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Federal Communications Commission
Office of Secretary

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Amendment of the Commission's Rules to Establish New Personal Communications Services Narrowband PCS	)))	**GEN Docket No. 90-314** **ET Docket No. 92-100**
	)	
Implementation of Section 309(j) of the Communications Act - Competitive Bidding Narrowband PCS	)))	**PP Docket No. 93-253**

To: The Commission

COMMENTS OF MERLIN TELECOM, INC.

MERLIN TELECOM, INC.

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SUMMARY

These Comments address Merlin Telecom, Inc.'s ("Merlin") concerns about the effects of the rule changes proposed by the FCC in its Further Notice of Proposed Rule Making regarding Narrowband PCS.

Merlin opposes the Commission's proposals to increase the interest rate on its installment payment plans, to lower the percentages of bidding credits available to small businesses, to raise or eliminate its narrowband PCS spectrum cap, and to increase the size of license areas to be auctioned. Merlin's opposition stems from the adverse result these changes would have on small businesses. Specifically, these proposals would cause small businesses to face higher capital costs and requirements which could prevent those small businesses from entering the market to provide narrowband PCS services.

Merlin supports the Commission's proposal to shift to a controlling principals test for attributable equity holders in a narrowband PCS applicant. However, Merlin urges the Commission to write rules which give some clear guidance to non-corporate entities regarding how to comply with the new rules.

Merlin supports the Commission's proposals to group the remaining narrowband PCS licenses together in a single auction to the extent that such grouping will result in an earlier auction. The earlier the FCC holds the next narrowband PCS auction, the better chance that new entrants have of succeeding in this industry. Finally, Merlin supports the Commission's proposal to allow partitioning by any qualifying entity, with the caveat that partitioning is not an adequate substitute for winning a license at auction unless an auction winner faces additional pressure not to warehouse its spectrum.

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MERLIN TELECOM, INC.

Merlin Telecom, Inc. ("Merlin"), by its attorneys, hereby respectfully submits these Comments in response to the *Report and Order and Further Notice of Proposed Rule Making ("Order and NPRM"* or *"NPRM")*, released by the Federal Communications Commission ("FCC" or "Commission") on April 23, 1997, in GEN Docket No. 90-314, ET Docket No. 92-100, PP Docket No. 93-253. These Comments support the FCC's proposals to: (1) auction more Narrowband PCS spectrum; (2) group licenses together in a simultaneous multiple round auction; (3) shift to a controlling principals test for attributable equity holders; and (4) allow partitioning generally by any potential licensee. The Comments oppose the FCC's proposals to: (1) increase the size of license areas; (2) raise the spectrum cap for Narrowband PCS licensees; and (3) use lower percentage bidding credits.

I. INTRODUCTION

Merlin is a telecommunications consulting firm primarily engaged in assisting small companies to participate in FCC auctions and to build and operate telecommunications systems. Merlin currently represents seventeen applicants for upcoming narrowband PCS license auctions. Merlin has played an integral part in the business and strategic planning for the potential applicants it represents. Merlin's clients have requested that it file these Comments to ensure that small businesses are treated fairly and consistently by the FCC's Rules. As discussed below, Merlin is extremely concerned that some of the FCC's tentative conclusions regarding its narrowband PCS rule changes will have a detrimental effect on small businesses, particularly those small businesses who have already made business plans in reliance on the existing rules.

Merlin's concerns are based in part on the cumulative effect of the Commission's proposals. While any one of the proposed changes, such as increasing the size of license areas, may not by itself preclude small businesses from entering the narrowband PCS business, the changes proposed when taken as a whole demonstrate that the FCC is abrogating its legal mandate under Section 309(j) of the Communications Act, as amended (Communications Act) to ensure that small businesses have an opportunity to acquire narrowband PCS licenses and enter the market to provide narrowband PCS services. For example, if the FCC raises the spectrum cap for narrowband PCS and increases the size of license areas while it eases a licensee's obligation to construct and operate its system, the Commission will create incentives for monopolistic warehousing of spectrum. Without stricter build out requirements, an incumbent licensee can reap monopoly profits on the spectrum it uses, and through those profits, it can afford to warehouse spectrum, even if it has paid for the spectrum at auction. Thus, the

Commission's approach to these rules will result in the creation of significant barriers to entry. Such rules clearly do not help small businesses.

II. DISCUSSION

A. LICENSING ISSUES

1. The Commission should not increase the size of geographic licenses for Narrowband PCS licenses still to be auctioned.

In the *NPRM,* the FCC proposes increasing the size of the geographic license areas it will auction for future Narrowband PCS spectrum. The *NPRM* proposes that the remaining spectrum be shifted from licenses covering 51 major trading areas (MTAs) and 493 basic trading areas (BTAs) to licenses that are mostly nationwide or regional, leaving only one block of spectrum which would be licensed on an MTA basis. *NPRM* at 15-16. The Commission specifically sought comment on "whether our proposals are equitable to existing licensees, and whether they would assist new entrants in offering services to the public in a more efficient manner." *Id.*

Merlin opposes increasing the geographic license size of these channels because it will deter new entrants from bidding to provide new Narrowband PCS services. Merlin has extensive experience working with small companies who plan to bid on narrowband PCS spectrum. These small companies have new, innovative ideas for service offerings using narrowband spectrum. Those companies generally have developed more creative uses for spectrum in response to specific demands in their target markets. Therefore, the success of these small businesses depends on their being able to develop a special niche service in a smaller area in order to become established. If the FCC shifts to large license areas for the unlicensed spectrum, the services provided over the spectrum will only be offered by large companies which currently have the wherewithal to enter this capital intensive business, and those services are likely to be less imaginative and less advanced, because the FCC's proposals will effectively foreclose innovators from the market.

Additionally, if the FCC shifts to larger license areas, the number of applicants who will consider participating in the auction for the spectrum will be reduced because the up-front cost of participation will be substantially higher than originally proposed. This is due to the higher up-front payments associated with the larger population of the larger geographic areas as a result of the Commission's use of a megahertz-pop formula to determine the upfront payment.

Smaller businesses waited to bid in the MTA and BTA auctions for Narrowband PCS spectrum because of the affordability of the proposed smaller license areas. The FCC's current proposal to shift to larger areas will have a disproportionately beneficial effect on those applicants who already won licenses at auction because they will be able to rely on their established presence in the market, past experience and greater borrowing ability to secure the larger licenses. Not only did Merlin's clients rely on the FCC to auction smaller areas, and develop business plans tailored to those smaller areas, they also expected that the FCC would treat them as fairly as the larger companies who already had the opportunity to bid in early auctions. If the FCC shifts to large license areas, it will merely ensure that fewer bidders have a chance to provide new services using Narrowband PCS spectrum.

2. The FCC should not raise the spectrum cap for Narrowband PCS.

The FCC requested comment on whether the narrowband PCS spectrum aggregation limit should be increased or eliminated. *NPRM* at 17. Merlin opposes eliminating or increasing the narrowband PCS spectrum aggregation limit. With spectrum a scarce resource, the FCC is obligated to the public to ensure that licenses are widely disseminated amongst licensees to ensure that the market for subscriber based services remains competitive. The spectrum cap is one of the only tools left in market-based spectrum management to ensure against excessive concentration of spectrum, and therefore economic power, in the hands of a few companies. Wider dissemination of licenses helps to meet Congress's stated directive that the Commission ensure that smaller companies, companies owned by women and members of minority groups and other designated entities have an opportunity to participate in the provision of spectrum-based services. Without the spectrum cap, or with too large a spectrum cap, larger companies, hoping to avoid competition, will be able to use their larger capital resources to prevent entry into the marketplace of newer, smaller competitors.

3. The FCC should allocate and auction the reserved spectrum.

Merlin believes that the FCC should allocate and auction the spectrum it has held in reserve for narrowband PCS use. Spectrum should be used to provide wireless telecommunications services to the public. Holding the spectrum in reserve does not encourage additional telecommunications service to the public. Additionally, making additional spectrum available will increase opportunity for new entrants to compete to provide narrowband PCS services. The Commission should , therefore, auction any newly allocated spectrum previously held in reserve in the same auction as the rest of the Narrowband PCS spectrum.

4. The FCC should open eligibility for paging response channels.

The FCC proposed to lift the eligibility restrictions on applying for paging response channels. Merlin supports the FCC proposal and agrees that "removal of eligibility restrictions will increase competition for these channels and thereby increase the likelihood that licenses for these channels will be awarded to those who value them most highly." *NPRM* at 20. Merlin also notes that this will encourage more new entrants into the Narrowband PCS services. Additionally, open eligibility for paging response channels will give greater flexibility to new licensees who can use these channels in conjunction with other spectrum to provide new services.

B. CONSTRUCTION AND COVERAGE REQUIREMENTS

The FCC has proposed conforming the narrowband PCS rules to the Commission's paging rules by allowing narrowband licensees to meet performance requirements either through a demonstration of substantial service or by meeting the coverage requirements provided under the existing rules.[1] The Commission defines "substantial service" as "service that is sound,

[1] The existing rules provide that: Nationwide narrowband licensees must serve 37.5 % of the U.S. population, or 750,000 square kilometers, within five years of the initial license date, and must serve 75% of the U.S. population or 1,500,000 square kilometers within ten years of the initial license date; regional narrowband licenses must serve 37.5 % of the population of the service area, or 150,000 square kilometers within five years of the initial license date, and 75% of the population of the license area, or 300,000 square kilometers, within ten years of the initial license date. For MTA licensees, they must cover 37.5% of the population of the service area or 75,000 square kilometers or 25% of the geographic service area within five years of the initial license date, and 150,000 square kilometers or 50% of the geographic area or 75% of the population of the service area within ten years of the license date. For BTA licensees, they must construct at least one base station within one year of the initial license grant date. 47 C.F.R. § 24.103.

favorable, and substantially above a level of mediocre service which would barely warrant renewal." *NPRM* at 22 (citations omitted).

Merlin opposes the FCC's proposal to shift to a "substantial service" construction and coverage requirement, particularly if the Commission pursues creating larger license areas. *NPRM* at 22. The combined effect of less stringent construction requirements and larger license areas is that larger bidders will take the spectrum and warehouse it until such time as they find uses for it. Spectrum warehousing is the practice of a licensee securing a license for spectrum and then holding it back from use to enhance the value of other spectrum that that licensee is using. Spectrum warehousing is anathema to the public interest. It does not enhance competition in the market for narrowband PCS services, nor will it bring service to the public sooner. The economics of creating a larger service area with fewer service requirements allow a bidder to face less risk in not constructing and operating its system. In fact, the potential for collusive or monopolistic behavior -- especially given the Commission's proposal regarding raising or eliminating the spectrum cap -- is greatly heightened by this proposal because the market will have fewer participants. A bidder which can warehouse spectrum can see a return on that spectrum in the form of monopolistic profits from the limited operations it undertakes. Thus, that bidder/licensee will not necessarily build out its system to recover the price bid at auction. This becomes an even more likely outcome if the smaller bidders are foreclosed from an auction because the Commission has created only national and regional licenses, except for the one block of MTA licenses.[2]

[2] Merlin questions the FCC's commitment to creating opportunities for smaller businesses to enter the market to provide narrowband PCS services given that the combined effect of many of the Commission's proposals would be to foreclose small companies from

C. AUCTION METHODOLOGY

1. Merlin supports use of a simultaneous multiple round auction.

Merlin supports the FCC's proposal to hold a simultaneous multiple round auction for the unlicensed narrowband PCS spectrum. Merlin does not oppose the FCC's proposal to retain the discretion to keep its auction open regardless of whether new bids have been placed or pro-active waivers have been used as long as this discretion is not used to drag out an auction.

2. The FCC should group licenses together in one auction to speed the licensing process.

Merlin supports grouping all of the remaining allocated narrowband PCS licenses in a single auction. This will increase the efficiency of the auction process by minimizing administrative costs and speeding the licensing process. It will also increase the ability of bidders to pursue back-up strategies in bidding on interdependent licenses. Merlin's clients are prepared to bid vigorously in an auction, and Merlin encourages the FCC to design its auction in such a way that the process is completed expeditiously so that the winning bidders can begin to provide service to the public as soon as possible. If the Commission allocates the remaining spectrum in this service, Merlin supports including that spectrum in the same auction. However, Merlin adamantly opposes any delay of the next narrowband PCS auction until the allocation is made, just so that the FCC can hold only one auction. The existing narrowband PCS licensees have already had such a head start in the market that any additional delay in auctioning the remaining spectrum is highly deleterious to the potential competitors who will win licenses in this auction. Accordingly, Merlin respectfully requests that the Commission hold an auction for this spectrum as soon as possible.

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effectively participating in an auction or building and operating a system.

3. The FCC should auction the paging response channels in conjunction with other narrowband PCS spectrum.

To the extent that the paging response channels can be included in the auction of other narrowband PCS spectrum, Merlin supports the FCC's proposal to include such channels in its next narrowband PCS auction. If eligibility for these channels is opened to all applicants, then it is logical to include these channels in the same auction as the other narrowband PCS licenses. It will help to allow bidders to pursue back-up strategies, and it will enhance the value of the licenses because bidders will be able to benefit from the interdependencies and complementarity of the licenses.

D. TREATMENT OF SMALL BUSINESSES

1. Merlin generally supports the FCC's Small Business Definition.

Merlin supports the FCC's proposed definitions of small businesses that qualify as designated entities for purposes of its next narrowband PCS auction. The Commission has proposed that a small business would be one which has gross revenues of not more than $40 million, as averaged over the last three years. *NPRM* at 32. The Commission also proposed that a very small business be defined as one with gross revenues of not more than $15 million, as averaged over the last three years. *Id.* The Commission proposed these definitions because the thresholds adequately reflect the difficulty that small and very small businesses have in accessing capital. Merlin agrees that those are the approximate thresholds below which it becomes increasingly more difficult to access the capital necessary to participate in the provision of narrowband services.

The small business and very small business thresholds set by the Commission are less important than the benefits the FCC makes available to bidders who meet those thresholds. In its proposed narrowband rules, the Commission is considering offering bidding credits of ten percent to small businesses ($40M level) and 15 percent to very small businesses ($15M level). *NRPM* at 35-36. It has proposed offering installment payments at the Treasury Note rate plus 2.5% for small businesses and at the Treasury Note rate plus 1.5% for very small businesses. *NPRM* at 37. Bidding credits and installment payments which significantly lower costs of capital to bidders are key to the success of a small new entrant in the market who seeks to provide spectrum based services. If bidding credits and the installment payment plan are as insubstantial as the Commission is currently proposing (*see infra* Sections II, D, 3 and 4), there will be no successful new entrants, no matter where the FCC sets the thresholds for measuring small businesses. Clearly, given the proposals in the *NPRM*, the Commission is not demonstrating a commitment to creating opportunities for small businesses to enter the narrowband PCS field. In failing to meet that challenge, the Commission is violating the directives of Section 309(j) of the Communications Act to promote economic opportunity and competition and ensure "that new and innovative technologies are readily accessible to the American people by avoiding excessive concentration of licenses and by disseminating licenses among a wide variety of applicants, including small businesses. . . " 47 U.S.C. § 309(j)(3)(B).

With respect to the Commission's inquiry about changing the small business thresholds for different channel blocks, Merlin recommends that the Commission avoid making its rules more complicated than necessary. As discussed above, the Commission's proposal to increase the size of license areas for the unlicensed narrowband PCS spectrum will preclude smaller companies from having a realistic opportunity to bid at and win a license in an auction. In seeking comment on higher small business thresholds for larger license areas, the Commission is admitting that large areas will be too big for legitimately small businesses to bid on and win in an auction. Only a combination of smaller licenses and larger bidding credits and more favorable installment payments can **create** new opportunities for companies to enter the narrowband PCS business, in compliance with Section 309(j) of the Communications Act. 47 U.S.C. § 309(j). Anything else, such as higher small business thresholds, amounts to nothing more than window dressing. The market for narrowband PCS needs new competitors to enter, to provide innovative services and to disperse more widely the economic power held by only a few current licensees. Only auctioning smaller license areas can effectively achieve that goal. Raising the revenue limits for small businesses would merely treat more companies as small without bringing in new competitors. Merlin opposes the FCC's approach to this issue.

2. Merlin generally supports the Commission's new attribution test.

The FCC proposes to create a standard measurement by which an applicant can determine which of its investors will be attributable to the applicant and which other companies will be considered affiliates of the applicant. The Commission proposes to abandon its use of bright line "control group" structures that it developed for earlier narrowband PCS auctions to determine if an applicant qualifies to bid as a small business. It proposes shifting to a review of the controlling principals of applicants and their affiliates. The Commission proposes to look at *de facto* and *de jure* control of the applicant as set forth in *Ellis Thompson Corp.* 76 Rad. Reg.. (P&F) 1125 (1994) and *Intermountain Microwave*, 24 Rad. Reg. (P&F) 983 (1963). The Commission asks whether it should adopt the new Small Business Administration definition of affiliate which includes companies under common control, companies where one controls another, or is controlled by another, and companies with ownership, management, contractual ties to the applicant or previous ties to the applicant. *Order, Memorandum Opinion and Order and Notice of Proposed Rule Making,* WT Docket 97-82 released February 28, 1997 at para. 29. (*Part 1 NPRM*). *See also NPRM* at 33-34.

Merlin supports the FCC's shift to a controlling principals test for looking at attributable investors in applicants for narrowband PCS licenses. The approach will give applicants greater flexibility in structuring themselves to work in today's complex business, capital and technological markets while still allowing a wider variety of businesses to comply fully with the Commission's rules for designated entities. At the same time, Merlin encourages the FCC to give some guidance to the public regarding what factors it will consider to evaluate whether an applicant meets the tests for *de facto* or *de jure* control. For example, the Commission specified that in a corporation where 50.1 percent of the voting stock is held by one company or individual or group of individuals those individuals will be considered the controlling principals, and they will all have their assets and revenues attributed to the applicant. *NPRM* at 34. However, the Commission did not state whether any percentage below 50.1 percent might also be considered controlling, nor did the Commission address the equity percentages that would be considered controlling in a non-corporate entity (*e.g.* limited liability companies or limited partnerships). While Merlin does not expect the Commission to enumerate each of the possible scenarios under which an applicant could demonstrate that its controlling principals have legal control, it encourages the Commission to give some more fulsome explanation of how *de jure* control can be established.

When the FCC created its publicly traded company exception to its small business rules for the Broadband PCS C block auction, it did not have experience with new business structures such as limited liability companies. The business community is changing to use new and more creative business structures which give applicants more favorable tax status while preserving the personal insulation from liability of a corporate structure. Yet, the new business entities are not corporations and, generally, the equity of the companies is not traded on an exchange. Therefore, for the Commission to treat these new business entities fairly, it needs to create rules which do not restrict the creativity of the entrepreneurs who will participate in auctions.

The Commission should give guidance to the business community regarding how to structure applicants to comply with this attribution standard. In setting out the guidelines, the FCC should be clear that its rules will be broadly written to adapt to various new business structures, such as limited liability companies (LLCs) without forcing the new businesses to fit into archaic business structure patterns. For instance, a widely held LLC should not be required to be publicly traded, like a corporation is, because LLC membership units are created under state laws which prohibit them from being traded on public exchanges. Still, widely held LLCs should be treated by the FCC as if they were widely held companies, allowing them to exclude as attributable investors those equity holders who are not in control of the applicant, as envisioned by *Intermountain Microwave*. Specifically, in the case of a widely held LLC, its *controlling members* would be attributed to the applicant, and their affiliates would be counted toward the applicant, but non-controlling members would be excluded from attribution, just as if they were small, non-controlling shareholders in a widely held corporation. For purposes of defining whether a company is widely held, whatever its form of business organization, the FCC should write its rules to state that a widely held company is one in which no single equity holder would have 15 percent of more of the equity of the applicant. This is the standard used for publicly traded companies in Part 24 of the Commission's Rules. 47 C.F.R. § 24.720. The rest of the equity in a widely held company should be held by investors holding ten percent or less of the equity of the applicant.

Merlin proposes that the FCC create some safe harbors to give some certainty to the business community as it structures auction applicants. One such safe harbor would be to establish that an applicant whose equity is widely held, where no single equity holder holds 15% of the equity, and all the rest of the equity is widely held amongst nine or more other equity holders, could exclude all its owners from attribution. In such a situation, like that created for publicly traded corporations, only the affiliates of the governing body of the applicant would be attributed to the entity. For example, the Commission could articulate that an applicant that complies with the more stringent tests set out for control groups in narrowband or broadband PCS would be in compliance under the new rules.

By permitting companies whose equity is widely held to exclude attributable investors, the Commission will make it possible for entrepreneurs to start small businesses which can participate in auctions without burdening the new companies with overwhelmingly onerous record keeping and reporting requirements. Thus, a small company with thirty or more investors could vest control in a management team and still exclude the gross revenues of small, passive investors who are clearly not in control of the venture. Given the significant capital requirements for starting up spectrum-based businesses, small companies find it necessary to bring in many investors to generate sufficient capital to create a viable bidder. However, not all those investors will be active in the management and operation of the business. If an investor's holdings in the applicant are less than ten percent of the equity of the applicant, and the controlling LLC members, partners, or officers and directors have at least ten percent of the equity, it should be made clear in the rules that such an applicant will not have to attribute all of the assets and revenues of all of its investors to the applicant.

Merlin is not trying to suggest that controlling LLC members, general partners, or officers and directors of corporations be exempt from affiliation rules, it is merely trying to establish that an applicant whose equity is widely held will not have to concentrate more than 50% of its equity into the hands of a few controlling principals. Clearly, Merlin supports the Commission's ability to scrutinize each applicant to ensure that *de facto* control rests in the hands of the managing members in an LLC, the designated partners in a general or limited partnership, or the officers and directors of a corporate applicant.

In the alternative, if the FCC needs to set thresholds, it should require that the controlling principals hold only 20 percent of the equity of an applicant, but also require that no other investor could hold 15 percent or more of the applicant, in a widely held company. Thus, the controlling principals will hold twice as much equity as any other investor, which will help to ensure that the controlling principals have *de facto* and *de jure* control. Yet, such a requirement will allow businesses the flexibility to use new forms of business organization to meet the needs of the modern marketplace. Additionally, this proposed rule will make it possible for an applicant to bring in additional equity investment so that it can increase its capital if it wins a license at auction.

3. Bidding Credits

Merlin does not support the FCC's proposals concerning bidding credits for these licenses -- small businesses receive only a ten percent bidding credits and very small businesses receive a scant 15 percent bidding credit -- because the levels of bidding credits will be too low to give small businesses the sort of assistance necessary to allow them to win licenses in the auction. In fact, the FCC raised its bidding credit levels, from 25 percent initially to 40 percent, between the first and second Narrowband PCS auctions because the original level of bidding credits were insufficient to allow small businesses a realistic possibility of winning a regional narrowband PCS license in an auction. *Third Memorandum Opinion and Order and Further Notice of Proposed Rule Making,* 10 FCC Rcd 175 (1994).[3] Now, even as the Commission proposes shifting to larger license areas, it is proposing to reduce the levels of bidding credits again. *NPRM,* at 35. There is no justification for this change in policy, especially given the empirical evidence from past auctions that higher bidding credits were the key to successful

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[3] The Commission stated, "If we are to meet the congressional goals of promoting economic opportunity and competition by disseminating licenses among a wide variety of providers, we must find ways to counteract effectively these barriers to entry." *Competitive Bidding Third Memorandum Opinion and Order*, 10 FCC Rcd 175 at ¶ 70. The Commission also noted that "small businesses also have not become major participant in the telecommunications industry." *Id.* at ¶ 71. The Commission proposed to reduce the bidding credit for businesses owned by women and/or minorities, but it also proposed to create an entrepreneurs' block so that the smaller entities would not have to bid against very large companies. Since in the current situation, the Commission is eliminating its entrepreneurs' blocks for narrowband PCS, it is appropriate to restore the bidding credit to a higher level to ensure meaningful opportunities for small businesses to enter the market to provide narrowband PCS services. *Competitive Bidding Third Memorandum Opinion and Order*, 10 FCC Rcd at ¶ 76, and note 117.

designated entity participation in the regional narrowband PCS auction, and where no designated entities won licenses in the nationwide narrowband PCS auction.[4] Merlin believes that it would be appropriate to have bidding credits of 25 percent for small businesses at the $40 million level and bidding credits of 40 percent for very small businesses at the $15 million level. Narrowband PCS need higher bidding credits than paging, 220 MHz services, or other similar narrowband commercial mobile radio services because Narrowband PCS is unencumbered spectrum which the winning bidders will have to develop from the ground up. The bidders will not be piggy-backing on incumbent systems to which they are merely adding channels or expanding existing coverage. New entry into the encumbered paging market is not very likely. Accordingly, in the existing paging services, which is heavily encumbered, it makes sense for the Commission to offer bidding credits of ten percent for small businesses and 15 percent for very small businesses. *Second Report and Order and Further Notice of Proposed Rule Making*, WT Docket No. 96-18, PP Docket No. 93-253, FCC 97-59, released February 24, 1997 at 81 ¶ 179. In the 220 MHz band, where the spectrum is only somewhat encumbered, the Commission gave small businesses a 15 percent bidding credit and very small businesses a 25 percent bidding credit. *Third Report and Order and Fifth Notice of Proposed Rule Making*, PR Docket No. 89-552, RM-8506, Gen Docket No. 93-252, PP Docket No. 93-253, FCC 97-57, released March 12, 1997, at 129 ¶ 298. These bidding credits are higher than those contemplated for narrowband PCS. Thus, the tentative decision in this narrowband PCS *NPRM* puts potential new entrants into the market for

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[4] "The first nationwide auction demonstrated that a 25 percent bidding credit may not be sufficient to ensure that designated entities have the opportunity to participate where narrowband PCS values are high." *Competitive Bidding Third Memorandum Opinion and Order*, 10 FCC Rcd at ¶ 72.

narrowband services in a disadvantageous position relative to their potential competitors, even as narrowband PCS potential entrants face greater obstacles to entry.

For new licensees to build systems from the start and get service to the public quickly, small business narrowband PCS licensees will need higher bidding credits to lower the up-front cost of entering the market to provide narrowband services. Larger bidding credits will be absolutely necessary if the Commission shifts, against Merlin's position, to regional and nationwide licenses. Only with a 40 percent bidding credit would a legitimate small business, such as those Merlin represents, have a realistic chance of competing in an auction with a large communications company. The Commission was charged by Congress with making new opportunities for smaller businesses to participate in the provision of these services. Adopting meaningful bidding credits is a vital part of achieving that goal. *See* 47 U.S.C. Section 309(j).

4. Merlin opposes any proposal to increase installment payment interest rates.

The FCC is proposing to reduce to a maximum of two years the amount of time that a licensee can make interest-only payments and to raise the interest rates at which winning bidders make payments. *NPRM* at 37, para. 81. Section 1.2110 of the Commission's Rules sets the installment payment interest rate generally at the Treasury Note rate. The Commission has now proposed increasing that amount by between 1.5 and 2.5 percent. While the Commission's rationale is that it offered a bargain before, *Part 1 NPRM* at para. 36-38, there is no reason why it should get a mark-up on the cost of capital. The Treasury Note rate is the cost of capital to the government. The FCC does not need to go to capital markets to borrow money to finance these installment payments. Thus, any percentage over the rate of a Treasury Note is pure profit to the government. It is an additional surcharge being visited upon only the smaller auction participants, not the larger bidders. This flies in the face of the goal of helping smaller businesses. The government is not entitled to profit off the hard work of small companies. Accordingly, Merlin supports keeping the interest rates at their original, reasonable levels.

a. Higher interest rates at the FCC raise the cost of capital.

Raising the interest rate on installment payments raises the cost of capital for small business auction participants. Small business auction participants will have greater overall debt liability if they face higher interest rates from the government. In that case, commercial lenders will raise the rates that small businesses pay for capital because the chances of default to them increase as the amount of debt increases.[5] Every time the FCC increases payments and rates, the cost of capital to small businesses increases because the demands on their scarce capital resources is higher. The FCC was instructed by Congress to help break down the barriers to accessing capital faced by small businesses, women- and minority-owned businesses. This

[5] A commercial lender's need to protect against loan defaults is very different from the FCC's need to protect against default on a license. The FCC as the licensing authority can always re-auction a license if the original auction winner does not fulfill its payment obligations, thus ensuring that it will recoup for the public a portion of the value of the spectrum. The government has no opportunity cost for which it needs immediate repayment. It does not face any out-of-pocket costs for issuing the license which would require immediate repayment. A commercial lender, in contrast, has to choose between lending to a variety of borrowers. It has shareholders and bank regulators which dictate the kinds of borrowers and returns that the lender must select. Therefore, the commercial lender faces limitations on its ability to defer repayment of a loan -- especially from the FDIC. Also, because the commercial lender cannot take a security interest in a license, it cannot seize the primary asset of a borrower to protect the money it has lent out, which it needs to recoup. Thus, the interests of the government and commercial lenders are *very different* and the rationale for protecting repayment to commercial lenders does not suffice to justify the government raising interest rates or down payments on licenses.

proposed rule change raises a barrier Congress instructed the FCC to reduce. Therefore, the Commission should not adopt this proposal.

Moreover, as the Commission's recent experience with winners of C and F Block broadband PCS licenses has demonstrated, interest payments can be highly burdensome to a company trying to construct a system. A new licensee's demand for capital resources is great, and if the FCC takes more of that scarce resource it threatens the viability of the new licensee. It is ironic and contradictory for the Commission to be raising interest rates while it is deferring interest payments to license winners from other auctions. *See Installment Payments for PCS Licenses,* D.A. No. 97-649, Wireless Telecommunications Bureau, released March 31, 1997, *see also* Public Notice D.A. No. 97-883, *FCC Announces Grant of Broadband Personal Communications Services D, E, and F Block BTA Licenses,* released April 28, 1997.

Merlin urges the Commission to be consistent in the rules it adopts to the extent that these issues are being addressed in this proceeding in addition to the ongoing proposal to re-write the Commission's general auction rules. *See NPRM* at 37-38, ¶ 81.

Additionally, Merlin opposes the Commission's proposal to apply a licensee's payment first to new late fees and penalties rather than to the debt the licensee owes the government. Because the FCC faces no cost of capital -- it does not borrow money to allow licensees to use installment payments -- it has no need to collect additional fees or penalties if a payment is late. It has the ultimate remedy if a licensee is in default or consistently late in making payments; it can cancel the license for failure to comply with the terms of the license. For these reasons, and given the more extensive analysis Merlin set out in its Comments in WT Docket 97-82, Merlin opposes the Commission's proposals to increase the interest rate on its installment payments and to impose new late fees and penalties.

E. PARTITIONING

Merlin supports general availability of partitioning to all designated entities. Should Merlin's clients be unsuccessful at the auction, Merlin would encourage them to pursue partitioning arrangements to give them a second opportunity to enter these businesses. However, the FCC should not rely on partitioning to provide meaningful opportunities for small businesses to enter the marketplace to provide narrowband PCS services without ensuring that partitioning is a meaningful option. Merlin has observed the broadband PCS post-auction licensing to determine whether geographic partitioning and spectrum disaggregation are viable methods for market entry, and it has determined that broadband PCS licensees are not open to partitioning and disaggregation. Moreover, a winning bidder is more likely to partition if there are significant build-out requirements. Without such incentives imposed by the Commission, partitioning will not be a likely method for new entrants to enter the narrowband PCS arena.

III. CONCLUSION

Congress recognized that competitive forces will increase the range of wireless services and lower the price of wireless services available to the public if new companies are able to participate in offering these new spectrum-based services. For that reason, it required the FCC to ensure that small businesses and other designated entities would be given benefits which would allow those entities to participate in the provision of services where the licenses were auctioned.